

The Patent Box Tax Incentive can help reduce your corporation tax to 10% – find out if you are eligible!



In brief:

The Patent Box regime was introduced in 2013 to encourage businesses to develop IP in the UK and provide tax relief on the profits arising from that IP. The patent box enables companies to apply a lower rate of corporation tax of 10% to profits arising from patented inventions or processes. With the corporation tax rate set to rise to 25% from 1 April 2023 the potential tax saving available to companies will rise to 15% on profits in patent box (currently a 9% saving today).



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Eligibility Criteria

To be eligible for patent box companies need to have the following:

- Directly hold, or have an exclusive license over qualifying IP rights i.e. an EPO or UK registered patent (or other eligible IP).
- The company or another group member has undertaken eligible development activity (R&D) in relation to the qualifying IP rights
- The company must have performed a significant amount of 'management activities' during the accounting period in relation to the qualifying IP rights
- Be a company liable to UK corporation tax, with profits arising from the invention.

The UK Patent Box regime is generous in its application with only one patent needed for a company to be eligible to bring all revenues from a product incorporating the patent into the patent box claim.

Qualifying Income

The following income qualifies for patent box:

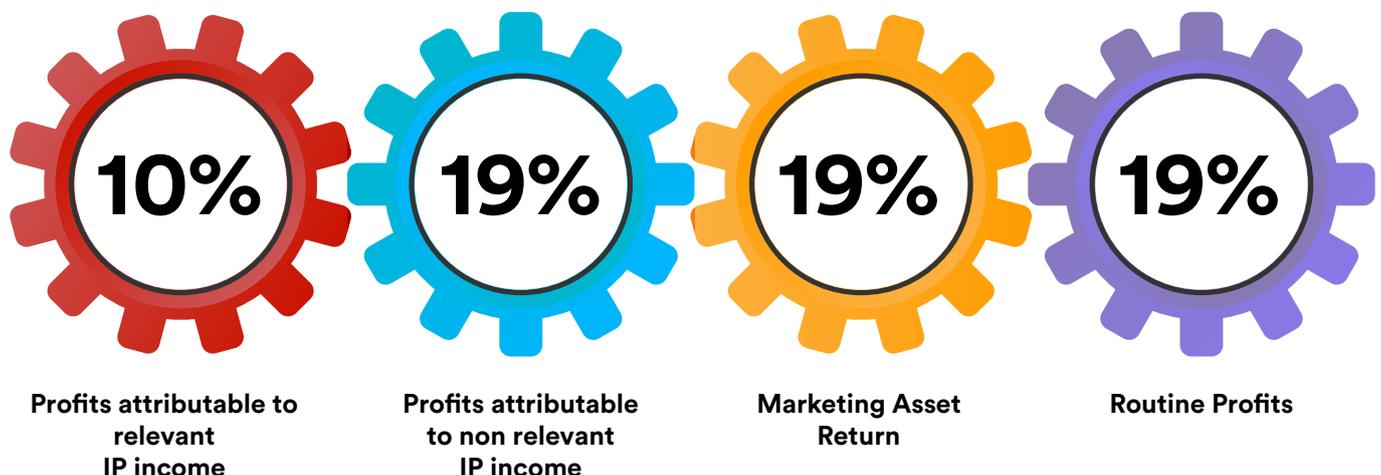
- Sales of patented products, including products that incorporate the patent and bespoke spare parts
- Licence fees or royalty income from granting rights over patents and other associated IP rights
- Proceeds from the disposal of patents
- Damages received for the infringement or alleged infringement of patent rights and other compensation payments
- Services income or income from patented processes

Calculation of the benefit

Profits need to be streamed between relevant and non relevant IP income streams before adjustments are made to remove excluded credits and debits and finance costs. An amount is then deducted from each relevant IP income stream for the 'routine return', this is 10% of 'routine deductions' included in calculating the profits of the stream. Routine deductions include capital allowances, premises costs, personnel costs, plant and machinery, professional services, and miscellaneous services.

The next step is to make an adjustment for the Marketing Asset Return (i.e. income earned from branding) so that only income arising from the IP remains in the patent box. This is done by calculating a notional marketing royalty using transfer pricing principles to consider what a third party would pay on an arm's length basis to exploit the marketing assets.

Where eligible, businesses can make a small claims election which provides a simplified method for calculating the notional royalty as 25% of the qualifying residual profit.



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Nexus Fraction

Once the resulting profit for each sub stream has been determined it is multiplied by the nexus fraction. This is calculated from the R&D expenditure relating to the development of the IP and effectively limits the amount of benefit to the proportion of R&D undertaken by the company in relation to the qualifying IP right.

This means that companies need to be able to track their R&D spend at the same level to which they are streaming the income. This can be by IP right, at a product, or product family level. New entrants to the patent box regime will need this data going back to 1 July 2016. The fraction is cumulative and updated every year and it is possible to elect to include data going back up to 20 years (if beneficial). Businesses that have developed their own IP in-house are unlikely to see any reduction in their level of benefit.

The terms of the fraction are as follows:

$$\frac{D + S1 \times 1.3}{D + S1 + S2 + A}$$

D = Qualifying expenditure on in-house R&D, externally provided workers and consumables

S1 = Qualifying expenditure on R&D subcontracted to unconnected parties

S2 = Qualifying expenditure on R&D subcontracted to connected parties

A = Qualifying expenditure on acquiring qualifying IP rights

How we can help

We can help you review your patents for eligibility, assist with mapping patents to the income that can be included in patent box, assessing an appropriate level for streaming, preparing of nexus fractions, and calculating the benefit. Whilst there is some complexity in making your first claim, the calculation is formulaic and can often be rolled forward for later periods with little effort.

If you don't currently have a patent but undertake R&D it is likely you may have something that can be patented as the requirements for patenting and R&D are similar. We can put you in touch with specialist patent attorneys who can help you identify what can be patented. If you opt in at the point of application you can accrue the benefit for the patent pending period which is then given in the tax return the year the patent is granted.

For more detailed information get in touch with our Innovations Tax team:

Emma Richards

emma.richards@wilson-partners.co.uk

Steve Lawrey

stephen.lawrey@wilson-partners.co.uk